The European insurance industry views on International Capital Standards (ICS)

IAIS Observer Hearing

20 October

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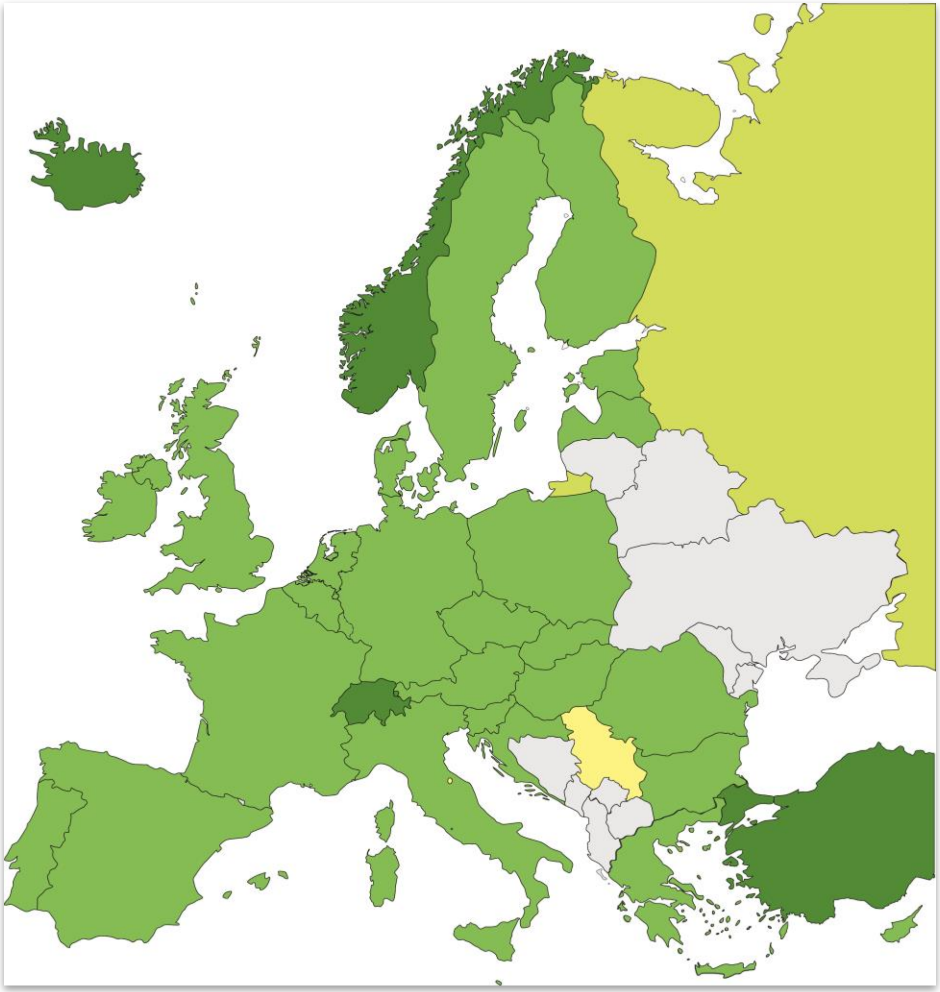
Insurance Europe



- European insurance market: largest market in the world (35% share in 2013)
  - €8.5trn investments
  - €1.1trn in premiums
  - €0.9trn in claims
- Insurance Europe represents around 95% of European insurance market by premium income
- 34 members (national associations)
  - **27 EU member states**
  - **5 non-EU markets** *(Switzerland, Iceland, Norway, Turkey, Liechtenstein)*
  - **2 associate members** *(Serbia, San Marino)*
  - **1 partner** *(Russia)*

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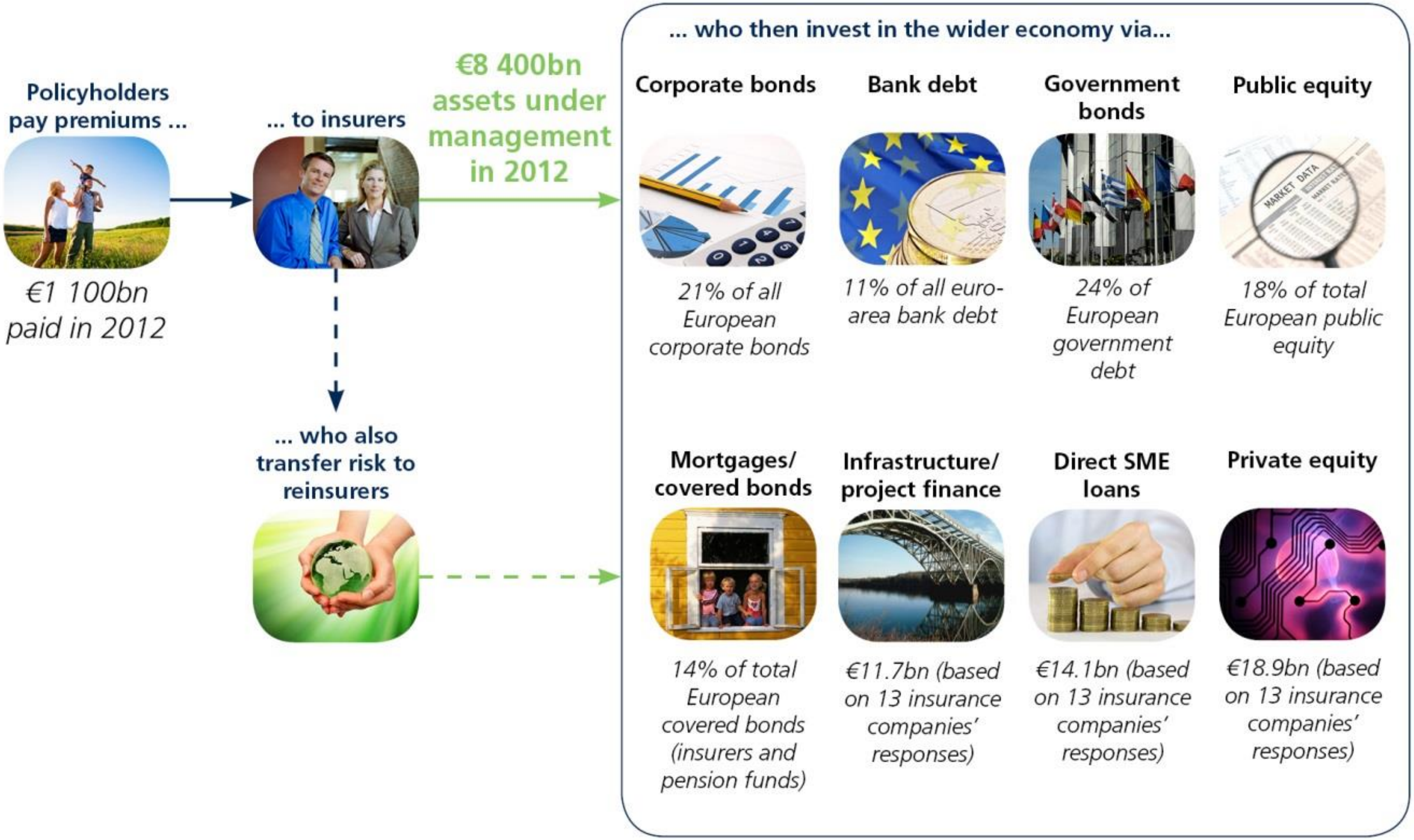
Europe’s largest institutional investor

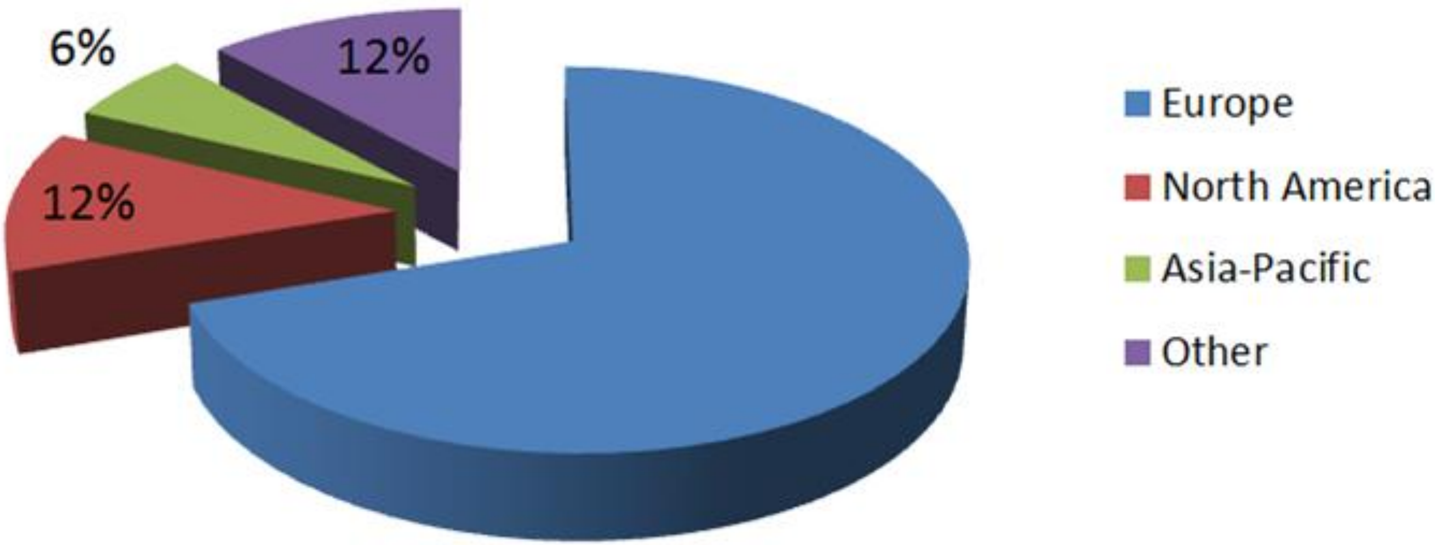


... providing long-term stable funding

Significant international presence

Where do premiums come from?

30% (€174bn) of Europe's top 20 insurers' premiums (€589bn) comes from outside Europe



Source: L'Argus de l'assurance (December 2013)

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Overall definitions of Solvency

- **Consolidated group-wide** balance sheet should be the basis for measuring capital adequacy
- **Solvency assessed** by comparing Available Capital to Required Capital
- **Sectorial requirements** should apply to non-insurance entities
- Target **level of solvency** is used for consistency of calibrations
- Business should be treated in a consistent way, for both life and non-life
- Solvency required and available capital should be **reported** in a transparent way
- The ICS aims at **comparable outcomes** across jurisdictions

These building blocks are in line with IAIS Principles 1, 2, 5, 9 and 10

Valuation basis

- Consistent valuation basis ensuring that the long-term nature and ALM are taken into account and therefore avoids “artificial” volatility in Available Capital

- **Assets** should be valued at **market value**

  and

- **Insurance liabilities**:
  - Valuation based on projection of best estimate cash flows (ie not conservative estimates)
  - Projected cash flows discounted using a discount rate which reflects the long-term nature of the business and how matching links assets and liabilities

These building blocks are in line with IAIS Principle 7 on avoiding pro-cyclical behaviour

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Available Capital

- Available Capital should be determined as the excess of assets over liabilities, plus subordinated liabilities

- Tiering and quality of capital resources must be based on ability to absorb risk (not arbitrary definitions)

- Available Capital should be determined on the basis of full fungibility of capital within the group (non-fungibility being the exceptional case)

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Required Capital (1/2)

- **Required Capital** should reflect the risk of **change in value** of the Available Capital to Target Level of Solvency
- **All major risks** that can materially impact Available Capital should be included (eg insurance, market risks, operational risk)

These building blocks are in line with IAIS Principle 4
on reflecting material risks

- **Risk mitigation (eg reinsurance, profit sharing, hedging), ALM and diversification** taken into account in determining the overall Required Capital

These building blocks are in line with IAIS Principle 6
on sound risk management

Required Capital (2/2)

- Capital should be determined based on a **scenario approach**

- The **requirements** should be calibrated at a certain confidence level over one year
  - The **minimum confidence level** should be explicitly defined as part of the ICS framework

- **Internal Models** (partial or full) should be allowed to determine solvency

These building blocks are in line with IAIS Principle 6
on sound risk management

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"As simple as possible, but not simpler"

- It has to actually work in practice!
- We understand the need for a balance between risk-sensitivity and simplicity. However, the ICS should represent an appropriate reflection of insurance risks.

These building blocks are in line with IAIS Principle 8 on the balance between risk sensitivity and simplicity

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Interaction with the 10 IAIS ICS principles

- An ICS that takes into account all the above building blocks would be fully consistent with the IAIS proposed ICS principles

- *Principle 3* is very much linked to the HLA development and decision that the ICS would replace the BCR is premature

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ICS and local regimes

- **Local regimes** which are **consistent** with the ICS framework should be recognised as a **suitable implementation** of the ICS framework, subject to sufficient supervisory control as part of the framework to ensure a level playing field
  - For example, we are confident that Solvency 2 will be considered as an acceptable implementation of the ICS framework

- **Approach to group capital issues**
  - Multinational groups should be allowed to use the local implementation of the ICS to build up their consolidated group capital requirement

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Challenges for development and implementation

- We need a better understanding of how likely it is for IAIS member countries to actually **adopt and implement the ICS framework globally**
  - For example, does the IAIS plan to seek global commitment and, more specifically, G20 commitment to support implementation?

- **Timing for development**
  - Remains ambitious as existing solvency regimes exhibit significant differences in key areas such as valuation

- **Timing for implementation**
  - Transitional measures should be part of the framework

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